

# A Hard Muffin to Swallow!

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## **What is the level of responsibility of each party in a franchising matter? What are the obligations of the lessor with respect to the sublessee in the absence of a contractual link between them?**

Last January, the Court of Appeal ruled on these subjects and discussed, among others, the question of the obligation of good faith of a lessor. The full judgement is available by following this link.

In this matter, a franchisee (the “**Franchisee**”) of the chain MMMuffins Canada Inc. (the “**Franchisor**”) had been operating a food kiosk as a sublessee in the food court of the Rockland mall in Montreal since 1993. In 2004, the owner of the mall, *Ivanhoé Cambridge Inc.* (the “**Lessor**”), decided to relocate the food court following renovations. The Lessor started negotiations with the Franchisor and the Franchisee who both finally accepted the proposed relocation, without knowing that the Lessor had just rented a kiosk to one of their direct competitors, Coffee Depot. The Lessor had not provided this information.

After relocation, the Franchisee noticed a significant reduction in earnings, claiming this was due to the presence of the Coffee Depot kiosk. The Franchisee argued that this kiosk was intercepting its potential customers because of the fact that the Coffee Depot kiosk was located directly at the entrance of the food court.

The Franchisee therefore decided to take legal action against the Lessor for loss of profits and depreciation of its business.

In its judgement, the Superior Court recognized the bad faith of the Lessor, but didn't award compensation to Franchisor for lost profits and depreciation of the business, stating that a sufficient causal link was not demonstrated.<sup>1</sup>

The Court of Appeal confirmed the initial judgement and took the opportunity to clarify certain important notions, notably the obligation of good faith.<sup>2</sup>

Due to the absence of a contract binding the Franchisee and the Lessor, the Lessor alleged that it had no obligation of good faith towards the Franchisee.

The Court of Appeal rejected this argument and stated that, even in the absence of an exclusivity clause or a contractual link, the Lessor must exercise its rights while respecting its obligation of good faith.

However, the court rejected Franchisee's argument that the location of Coffee Depot's kiosk constituted unfair competition. Indeed, the court reminded the parties that the Lessor has the right to use its space as it wishes, as long as it does not abuse of its right. Therefore, the Lessor had the obligation to inform the Franchisee of the fact that a direct competitor would occupy the kiosk located at the entrance of the food court. This would not however prevent the Lessor from

actually renting the location to the competitor.

We learn from this case that, in a franchising matter, a lessor has several obligations towards a sublessee, even if no contract binds them. The lessor has to prove good faith and can be found liable of damages caused to a sublessee by its fault, even without a direct contractual obligation. It is also prudent for a franchisor to ensure the welfare of its franchisees. This is a matter that our courts are being asked to consider more frequently.

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<sup>11</sup> 2855-0523 *Québec inc. v. Ivanhoe Cambridge inc.*, 2011 QCCS 6624

<sup>12</sup> 2855-0523 *Québec inc. v. Ivanhoe Cambridge inc.*, 2014 QCCA 124